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FILED
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No. 169

IN THE

Supreme Court of the United States

OCTOBER TERM, 1960

POLAROID CORPORATION,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

SUPPLEMENTAL REPLY BRIEF FOR PETITIONER

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SUPPLEMENTAL REPLY BRIEF FOR PETITIONER

In Point II of our main brief we asserted the alternative position that if Polaroid's income from its basic scientific discoveries was not entitled to be classified as "discovery" income under subparagraph (B) of Section 456(a)(2), such income was entitled to classification under the last sentence of Section 456(a)(2), which provided for additional classifications of income of "any class" under regulations prescribed by the Secretary. With respect to such contention, the Government in its Reply Brief has advanced for the first time the argument that this last

sentence was included in the section through inadvertence. No such contention was made by the Government in its principal brief in this case or the *Searle* case, nor was any such contention made by the Government in either case in the Courts below. The purpose of this Supplemental Reply Brief for Petitioner is to answer this last-minute contention of the Government.

I

Contrary to the Government's contention, the legislative history shows that the last sentence of Section 456(a)(2) was deliberately included.

The Government's argument that the last sentence of Section 456(a)(2) was included in the section by inadvertence is refuted by the legislative history. It is based entirely on a misinterpretation of the effect of a clerical amendment by the Senate to Section 456(a)(1).

In the original House bill, Section 456(a)(1) [Section 454(A)(1) of the House bill] the term "abnormal income" was defined as embracing "income of any class includible in the gross income of the taxpayer", if the amount of such income of such class exceeded the average of the gross income of the same class for the four prior taxable years. Section 456(a)(2) [Section 454(A)(2)] of the original House bill set forth the four expressly defined classes of income which appear in the section as finally enacted, as well as the last sentence: "The classification of income of any class not described in subparagraphs (A) to (D), inclusive, shall be subject to regulations prescribed by the Secretary".

The Senate Finance Committee proposed two amendments: Amendment 200 sought to add after the words

"income of any class" in paragraph (a)(1) the words "described in paragraph (2)". Amendment 201 sought to strike out the last sentence of paragraph (a)(2), thus limiting the relief to only the four classes of income expressly defined in that paragraph.

In Conference, the Senate receded from its Amendment 201; and the last sentence of paragraph (a)(2), providing for additional classifications pursuant to regulations to be prescribed by the Secretary, was left intact. (H.R. Rep. No. 3233, Conference Report, 81st Cong. 2d Sess. 1951-1 Cum. Bull. 268, 277.)

That this action on the part of the Senate was not inadvertent, as the Government asserts, but was deliberately done for the purpose of extending the scope of the section to other classes of income in addition to those expressly described, as it had been extended under Section 721(a)(2) of the Second World War Act, is confirmed not only by the reference in the report of the Staff of the Joint Committee* to "income of other classes permitted under regulations prescribed by the Secretary", to which the Government adverts in Point III of its Reply Brief (Gov't's Reply Br. p. 10), but also by the following comment of Senator George in reporting on the House—Senate Conference on the Senate floor:

> "In connection with abnormalities in income in the tax period, the Senate conferees receded on a House bill provision which would give the Secretary of the Treasury the authority to prescribe classifications in addition to those specified in the bill." (96 Cong. Rec. p. 16,978, December 22, 1959.)

* Summary of H.R. 9827 "The Excess Profits Tax Act of 1950 as Agreed to by the Conferees, prepared by the Joint Committee on Internal Revenue Taxation, December 1950, p. 9.

With respect to the Senate's other amendment, No. 200, the Conference report stated: "Amendments Nos. 194, * * * 200: These are clerical amendments. The House recedes". (H.R. Rep. No. 3231, Conference Report, 81st Cong. 2d Sess. 1951-1 Cum. Bull. 268, 277.)

It thus is apparent that no substantive change was intended by Amendment 200 which added to the definition of abnormal income in paragraph (a)(1) after the words "income of any class" the phrase "described in paragraph (2)". This was a clerical language change which did not change the meaning of the definition of abnormal income as worded in the original House bill. The only proposed amendment that was substantive in nature was No. 201, to delete the last sentence of paragraph (a)(2), and on this the Senate receded and agreed to the inclusion of such last sentence.

Nor is there any contradiction, as the Government asserts, between paragraph (a)(1) with the words "as described in paragraph (2)" and paragraph (a)(2) with the last sentence included. The phrase "described in paragraph (2)" is tantamount to "hereinafter classified" and refers not only to the four classes expressly described in subparagraphs (A)-(D) of paragraph (2) but also to the additional classes to be established pursuant to the last sentence of paragraph (2).* All that the addition of the phrase accomplished was to make crystal clear in the definition of abnormal income that it was not income of "any

* Webster's New International Dictionary (2d Edition) gives as one of the definitions of the word "describe", "5. to distribute into parts, groups or classes; to mark off; to class; to apportion." Substituting that definition for the phrase "described in paragraph (2)", paragraph (a)(1) of Section 456 would read: "The term 'abnormal income' means income of any class distributed into parts, groups or classes in paragraph (2) * * *."

class", as such class of income might be unilaterally conceived by the taxpayer, but income of "any class", as either expressly described in paragraph (2) or thereafter described by the Secretary for the additional classes to be established pursuant to the last sentence, that was to be subjected to the mathematical formula for determination of abnormality. While this clarification was not essential since the provision without the added phrase had been similarly interpreted, it was helpful as eliminating any possible doubt as to interpretation.

In converting a clerical amendment into a substantive amendment to support an argument, contrary to the demonstrated legislative history, that the inclusion of the last sentence was inadvertent, the Government would have one believe that (i) the House did not know what it was doing when it drafted the original bill with the last sentence of paragraph (a)(2) included, (ii) the Senate conferees did not know what they were doing when they receded from their amendment to delete this last sentence, (iii) the Senate and House conferees did not know what they were doing when they characterized as a clerical amendment the Senate amendment which added the phrase "as described in paragraph (2)" to paragraph (1), and (iv) the Joint Committee staff and Senator George were in error in stating that additional classifications of income under regulations to be prescribed by the Secretary had been provided for in the statute, as finally enacted. The Government's argument ascribes no meaning whatever to the Senate's action, after the conference, of receding from the only proposed substantive amendment it made, to eliminate the last sentence of paragraph (2). In effect, the Government, in its argument, has made the technical

amendment one of substance, and the substantive amendment a technical one.

The failure of the House Committee report,* in reporting the bill, to make any reference to the omnibus provision in the last sentence of paragraph (a)(2) is explained by the fact that the bill was making no change in such respect from the comparable provision in Section 721(a)(2) of the Second World War Act and accordingly no reason existed for any comment concerning it in the Committee Report. The Committee Report confined itself to a statement of the changes which had been made in the bill from the provisions of the prior law, and of the purpose of such changes.

We respectfully submit that the legislative history conclusively demonstrates that the House from the outset intended to include in paragraph (a)(2) the omnibus provision for additional classifications by the Secretary, as had been provided in Section 721(a)(2) of the old law, that the Senate at first sought to eliminate such provision and confine abnormal income to the four classes expressly defined in the statute, but that the Senate thereafter deliberately yielded to the point of view of the House and agreed to abandon its amendment and to restore the omnibus provision which, in virtually identical language to that used in Section 721(a)(2), provided for additional classifications of income of "any class" under regulations to be prescribed by the Secretary.

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* H.R. Rep. No. 3142, 81st Cong. 2d Sess., 1951-1 Cum. Bull. 550.

II

The last sentence of Section 456(a)(2) requires the classification of all classes of income not expressly classified in such section.

Both Section 456(a)(2) and Section 721(a)(2) of the prior law, in virtually identical language, provided in their respective last sentences for "the classification of income of any class" not described in the subparagraphs of the section. In Section 456(a)(2) such classification is "subject to regulations prescribed by the Secretary"; in Section 721(a)(2) the classification was "subject to regulations prescribed by the Commissioner with the approval of the Secretary".

The Government concedes that under Section 721(a)(2) it was mandatory for the Commissioner to classify all classes of income not expressly described in the section, and that the test of whether such income was abnormal income was provided by the mathematical formula set forth in Section 721(a)(1).

The Government's argument in Point III of its Reply Brief that the same result does not obtain under the identical language of Section 456(a)(2) is based solely on its misconception of the effect of the clerical amendment which added in Section 456(a)(1) the phrase "described in paragraph (2)" after the words "income of any class". As we have shown in Point I hereof, the inclusion of this phrase effected no substantive change and the definition of abnormal income in Section 456(a)(1) (except for the change in the percentage in the formula for determining

abnormality) should be construed as the same as that in Section 721(a)(1).

Section 456(a)(2), we submit, is a classification section, to be used only as a tool for the determination of abnormality under Section 456(a)(1), as Section 721(a)(2) was used to determine abnormality under Section 721(a)(1). The addition of the phrase "described in paragraph (2)" in Section 456(a)(1) does not limit the operability of that subsection, as the Government contends. The formula there provided for the determination of abnormal income is operable with respect to any class of income, whether it is a class of income expressly described in the statute or an additional class of income established pursuant to the last sentence of paragraph (2).

Notwithstanding that this last sentence provides for classification of "income of any class", the identical words used in Section 721(a)(2), the Government has advanced the strange argument that these identical words should be given different interpretations. While the Government concedes that these words, as used in Section 721(a)(2), required the classification of all classes of income, the same words, as used in Section 456(a)(2), are stated to give the Secretary the discretion to elect to classify some classes of income but to refuse to classify others.

We respectfully submit that there is no justification for this claimed difference in the purport of identical words in identical provisions. The reference in the Committee reports to the deletion of "research, or development of tangible property", which had appeared in Section 721(a)(2)(C) as a part of one enumerated class of income, constitutes no basis for twisting the language of the statute requiring classification of all classes of income into a provision giving the Secretary a discretion to determine

eligibility for relief. Moreover, such interpretation would make the provision unconstitutional, as has been pointed out in our main brief.

March 17, 1961.

Respectfully submitted,

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SUPREME COURT OF THE UNITED STATES

Nos. 151 AND 169.—OCTOBER TERM, 1960.

John T. Jarecki, Former Collector of Internal Revenue, et al., Petitioners, v. G. D. Searle & Co.	On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit.
151	
Polaroid Corporation, Petitioner, v. Commissioner of Internal Revenue.	On Writ of Certiorari to the United States Court of Appeals for the First Circuit.
169	

[June 12, 1961.]

MR. CHIEF JUSTICE WARREN delivered the opinion of the Court.

These cases present problems in the interpretation of § 456 (a) of the Internal Revenue Code of 1939, a section of the Excess Profits Tax Act of 1950, 64 Stat. 1137. The Act, which is intended to tax at high rates unusually high profits earned during the Korean War, imposes a tax on profits in excess of an amount deemed to represent the taxpayer's normal profits.[1] Recognizing, however, that some profits otherwise subject to tax under this scheme might stem from causes other than the inflated wartime economy, Congress enacted § 456. This section grants relief in certain cases of "abnormal income" as defined in § 456 (a) [2] by allocating some of this income

[1] See H. R. Rep. No. 3142, 81st Cong., 2d Sess. 2, S. Rep. No. 2679, 81st Cong., 2d Sess. 2.

[2] Section 456 (a) provides in part:

"(a) *Definitions.* For the purpose of this section—

"(1) *Abnormal income.* The term "abnormal income" means income of any class described in paragraph (2) includible in the gross

to years other than those in which it was received for purposes of computing the tax.

The dispute in these cases is whether income from the sales of certain new products falls within the statutory definition of "abnormal income." Taxpayers claim that the income from the sales of their products is income resulting from "discovery." They claim it is therefore "abnormal income" within the class defined by § 456 (a)(2)(B) as

> "Income resulting from exploration, discovery, or prospecting, or any combination of the foregoing, extending over a period of more than 12 months."

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income of the taxpayer for any taxable year under this subchapter if it is abnormal for the taxpayer to derive income of such class, or, if the taxpayer normally derives income of such class but the amount of such income of such class includible in the gross income of the taxable year is in excess of 115 per centum of the average amount of the gross income of the same class for the four previous taxable years, or, if the taxpayer was not in existence for four previous taxable years the taxable years during which the taxpayer was in existence.

"(2) *Separate classes of income.* Each of the following subparagraphs shall be held to describe a separate class of income:

"(A) Income arising out of a claim, award, judgment, or decree, or interest on any of the foregoing; or

"(B) Income resulting from exploration, discovery, or prospecting, or any combination of the foregoing, extending over a period of more than 12 months; or

"(C) Income from the sale of patents, formulae, or processes, or any combination of the foregoing, developed over a period of more than 12 months; or

"(D) Income includible in gross income for the taxable year rather than for a different taxable year by reason of a change in the taxpayer's method of accounting.

"All the income which is classifiable in more than one of such subparagraphs shall be classified under the one which the taxpayer irrevocably elects. The classification of income of any class not described in subparagraphs (A) to (D), inclusive, shall be subject to regulations prescribed by the Secretary."

Taxpayer in No. 151 is a corporation engaged in the manufacture and marketing of drugs. As a result of research extending for more than 12 months, it produced two new drugs, "Banthine," used in the treatment of peptic ulcers, and "Dramamine," for relief from motion sickness. Taxpayer received patents on both drugs, and it asserts that both were new products and not merely improvements on pre-existing compounds. Taxpayer received income from the sale of "Banthine" and Dramamine" in the years 1950 through 1952. It paid its tax without claiming relief under § 456, and then claimed a refund. On denial of its claim, taxpayer filed a complaint in the District Court for the Northern District of Illinois. The District Court dismissed the complaint, but the Court of Appeals for the Seventh Circuit reversed. It held that "discovery" might include the preparation of new products and that the case must be remanded for a trial on the issue of whether taxpayer's drugs "were actually discoveries." 274 F. 2d 129, 131.

Taxpayer in No. 169 is the inventor and producer of the "Polaroid Land Process," a camera and film which produce a photograph in 60 seconds, and the "Polaroid 3–D Synthetic Polarizer," a device incorporated in the "viewers" through which audiences watched the three dimensional motion pictures in vogue some years ago. These inventions, each the product of more than 12 months research, are novel, according to taxpayer, and each has been patented. The Polaroid Land equipment was the subject of 238 patents by the end of 1958, and taxpayer characterizes this invention as "revolutionary." Its production was a new departure in the business of taxpayer, which had hitherto been engaged primarily in manufacturing and selling such optical products as polarizing sunglasses, visors and camera filters. In its returns for 1951 through 1953 taxpayer utilized the provisions of

§ 456 in computing its tax on income from the sales of its photographic equipment and 3–D polarizers. The Commissioner determined that § 456 was not applicable, and the Tax Court upheld his determination of a deficiency. The Court of Appeals for the First Circuit affirmed, holding that taxpayer's inventions were not "discoveries" and its income from their sale not "abnormal income." 278 F. 2d 148.

We granted certiorari in each case to resolve the conflict between the decisions of the First and Seventh Circuits. 364 U. S. 812, 813.

I.

For present purposes we accept, as did the First Circuit, taxpayers' assertions of the novelty of their products. But we also agree with that court that taxpayers' inventions are not "discoveries" as that word is used in § 456 (a)(2)(B) and that income from sales of the new products may not receive the special treatment provided by § 456.

We look first to the face of the statute. "Discovery" is a word usable in many contexts and with various shades of meaning. Here, however, it does not stand alone, but gathers meaning from the words around it. These words strongly suggest that a precise and narrow application was intended in § 456. The three words in conjunction, "exploration," "discovery" and "prospecting," all describe income-producing activity in the oil and gas and mining industries, but it is difficult to conceive of any other industry to which they all apply. Certainly the development and manufacture of drugs and cameras are not such industries. The maxim *noscitur a sociis*, that a word is known by the company it keeps, while not an inescapable rule, is often wisely applied where a word is capable of many meanings in order to avoid the giving of unintended

breadth to the Acts of Congress. See, *e. g.*, *Neal* v. *Clark*, 95 U. S. 704, 708–709. The application of the maxim here leads to the conclusion that "discovery" in § 456 means only the discovery of mineral resources.

When we examine further the construction of § 456 (a)(2) and compare subparagraphs (B) and (C), it becomes unmistakably clear that "discovery" was not meant to include the development of patentable products. If "discovery" were so wide in scope, there would be no need for the provision in subparagraph (C) for "income from the sale of patents, formulae, or processes." All of this income, under taxpayers' reading of "discovery," would also be income "resulting from . . . discovery" within subparagraph (B). To borrow the homely metaphor of Judge Aldrich in the First Circuit, "if there is a big hole in the fence for the big cat, need there be a small hole for the small one?" The statute admits a reasonable construction which gives effect to all of its provisions. In these circumstances we will not adopt a strained reading which renders one part a mere redundancy. See, *e. g.*, *United States* v. *Menasche*, 348 U. S. 528, 538–539.

Taxpayers assert that it is the "ordinary meaning" of "discovery" which must govern. We find ample evidence both on the face of the statute and, as we shall show, in its legislative history that a technical usage was intended. But even if we were without such evidence we should find it difficult to believe that Congress intended to apply the layman's meaning of "discovery" to describe the products of research. To do so would lead to the necessity of drawing a line between things found and things made, for in ordinary present-day usage things revealed are discoveries, but new fabrications are inventions.[3] It

[3] In lay terms, Polaroid's photographic equipment and Searle's drugs are probably better called inventions than discoveries. Webster's New International Dictionary, Unabridged (2d ed.) p. 745,

would appear senseless for Congress to adopt this usage, to provide relief for income from discoveries and yet make no provision for income from inventions. Perhaps in the patent law "discovery" has the uncommonly wide meaning taxpayers suggest, but the fields of patents and taxation are each lores unto themselves, and the usage in the patent law (which is by no means entirely in taxpayers' favor) [4] is unpersuasive here. All the evidence is to the effect that Congress did not intend to introduce the difficult distinction between inventions and discoveries into the excess profits tax law.

The relevant legislative history fortifies the conclusions to which the words of the statute lead us. The word "discovery" has been used for many years in the tax laws, and has always been used with the limited meaning of the finding of mineral deposits. In the Revenue Act of 1918, enacting one of the earliest excess profits tax laws, a limit was placed on the excess profits tax on income from "a bona fide sale of mines, oil or gas wells, or any interest therein, where the principal value of the property has been demonstrated by prospecting or exploration and discovery work done by the taxpayer." Revenue Act of

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makes this distinction: "One discovers what existed before, but had remained unknown; one invents by forming combinations which are either entirely new, or which attain their end by means unknown before: as, Columbus *discovered* America; Newton *discovered* the law of gravitation; *Edison* invented the phonograph. . . ."

[4] The United States Constitution, Art. I, § 8, cl. 8 gives Congress the power to secure to "Inventors the exclusive Right to their . . . Discoveries." While the terms "discover" and "discovery" are used throughout the patent statutes, they seem generally to appear with "invent" and "invention" as if the terms have separate meanings. See, *e. g.*, 35 U. S. C. § 101: "Whoever invents or discovers any new and useful process, machine, manufacture, or composition of matter . . . may obtain a patent therefore. . . ." And see *Dolbear* v. *American Bell Telephone Co.* (*Telephone Cases*), 126 U. S. 1, 532–533.

1918, § 337, 40 Stat. 1096.[5] An identical limitation was imposed on the income tax levied under that Act,[6] and the same usage of "discovery" obtained in the allowance of depletion deductions.[7] The limitation on the income tax on the proceeds of the sale of mineral deposits was re-enacted without significant change in the Revenue Acts of 1921, 1924, 1926, 1928, 1932, 1936 and 1938.[8] It remains in the income tax provisions of the Internal Revenue Code of 1939 as § 105 and has been carried forward as § 632 of the 1954 Code. In each re-enactment "discovery" is linked with "exploration" and "prospecting," and in each the word is restrictively applied to extractive industries. A correspondingly narrow use of "discovery" has continued since 1918 in the depletion allowance sections[9] and appears in § 114 (b)(2) of the 1939 Code. In the more than 30 years preceding the enactment of the sec-

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[5] This section was re-enacted by the Revenue Act of 1921, § 337, 42 Stat. 277.

[6] Revenue Act of 1918, § 211 (b), 40 Stat. 1064.

[7] Revenue Act of 1918, §§ 214 (a)(10), 234 (a)(9), 40 Stat. 1067, 1078, providing "That in the case of mines, oil and gas wells, discovered by the taxpayer . . . where the fair market value of the property is materially disproportionate to the cost, the depletion allowance shall be based upon the fair market value of the property at the date of discovery. . . ."

[8] Revenue Act of 1921, § 211 (b), 42 Stat. 237; Revenue Act of 1924, § 211 (b), 43 Stat. 267; Revenue Act of 1926, § 211 (b), 44 Stat. 23; Revenue Act of 1928, § 102 (a), 45 Stat. 812; Revenue Act of 1932, § 102 (a), 47 Stat. 192; Revenue Act of 1936, § 105, 49 Stat. 1678; Revenue Act of 1938, § 105, 52 Stat. 484.

[9] Revenue Act of 1921, §§ 214 (a)(10), 234 (a)(9), 42 Stat. 241, 256; Revenue Act of 1924, § 204 (c), 43 Stat. 260; Revenue Act of 1926, § 204 (c)(1), 44 Stat. 16; Revenue Act of 1928, § 114 (b)(2), 45 Stat. 821; Revenue Act of 1932, § 114 (b)(2), 47 Stat. 202; Revenue Act of 1934, § 114 (b)(2), 48 Stat. 710; Revenue Act of 1936, § 114 (b)(2), 49 Stat. 1686; Revenue Act of 1938, § 114 (b)(2), 52 Stat. 495.

tion here at issue, during which time "discovery" was used and re-used in successive taxing statutes, the word developed into a term of art of precise and limited meaning.

The Excess Profits Tax Act of 1940, 54 Stat. 975, made specific mention of more types of "abnormal income" qualifying for relief than did the earlier excess profits tax statutes, but there is no indication that it worked any transformation in the meaning of "discovery." Section 721, 54 Stat. 986, as amended, 55 Stat. 21, classified six types of "abnormal income." Among them was the following, at § 721 (a)(2)(C):

> "Income resulting from exploration, discovery, prospecting, research, or development of tangible property, patents, formulae, or processes, or any combination of the foregoing, extending over a period of more than 12 months."

This was the first time specific provision was made for income from invention, relief in cases of such income having previously been obtainable, if at all, only under the "general relief" provisions of the earlier Acts.[10] It is instructive that the formula "exploration, discovery, or prospecting" was not considered broad enough to cover invention and that the words "research" and "development" were added to cover that source of income. Plainly, "discovery" retained in the World War II excess profits Act the limited meaning which it had had in the

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[10] Section 327 (d) of the Revenue Act of 1918, 40 Stat. 1093, gave the Commissioner power to grant relief in any case in which "the tax . . . would, owing to abnormal conditions affecting the capital or income of the corporation, work upon the corporation an exceptional hardship. . . ." Section 721 of the World War II law classified specific types of abnormal income for purposes of computing the tax, and, while it provided relief for all abnormal income of whatever class, was not considered a "general relief" section.

previous Acts and which it continued to have in the income tax provisions of the then-current code.[11]

The relief provisions of the Excess Profits Tax Act of 1950, which we here construe, were modeled in part on § 721 of the World War II Act, but were different in significant respects. In the classifications of income in the new § 456, Congress gave separate treatment to income from discovery of minerals and income from invention. It provided relief in subparagraph (B) for "income *resulting from* exploration, discovery, or prospecting," but provided in subparagraph (C) only for "income *from the sale of* patents, formulae, or processes." (Emphasis added.) Subparagraph (C) does not encompass all income from inventions. It does not cover income from the sale of products made under a new patent, the sort of income at issue here. Taxpayers assert that the income from their inventions is, realistically speaking, as "abnormal" in their businesses as the discovery of a new mine would be in the business of a prospector. Their income is within the spirit of § 456, they say, and should be held to be within the letter of subparagraph (B). It is clear, however, that Congress, while it may have recognized the abnormal nature of this sort of income, chose deliberately to deny relief for it and to limit relief in cases of research and development to that provided in subparagraph (C).

The relief provisions of the World War II Act had been intended to provide "flexible rules," [12] and their application had often been an uncertain affair. In administering § 721 the Commissioner often faced the difficult task

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[11] I. R. C. of 1939, §§ 105, 114 (b)(2). It was expressly provided by § 728 of the World War II excess profits tax statute, 54 Stat. 989, that the words used in that statute should have the same meaning as when used in the income tax chapter of the Code.

[12] H. R. Rep. No. 146, 77th Cong., 1st Sess. 2.

of separating income which was the product of "research or development" from that resulting merely from improved management or sales efforts. The difficulty of distinction led the Tax Court to hold that the distinction must be made "by exercising common sense and judgment," and that "It is entirely possible that the allocation made by one person would never match that made by another." *Ramsey Accessories Mfg. Corp.* v. *Commissioner*, 10 T. C. 482, 489. Congress in 1950 recognized the delay and uncertainty caused by the element of administrative discretion in this and other [13] sections and set about drafting an excess profits tax law on the principle that "subjective judgments . . . should be avoided in the new law." H. R. Rep. No. 3142, 81st Cong., 2d Sess. 20. This principle was expressly followed in the drafting of § 456. The Senate Committee reported on § 456 as follows:

> "The equivalent provision in the World War II law (sec. 721) also permitted adjustments with reference to certain other types of income, particularly that resulting from the sale of tangible property arising out of research and development which extended over a period of more than 12 months. This provision in the old law was a potential loophole of major dimensions. Because there appeared to be no means of restricting such an adjustment to truly meritorious cases other than by the introduction of a large degree of administrative discretion of the type required by the general relief clause of the World War II law (sec. 722), and because the need for a

[13] The "general relief" section of the World War II Act, § 722, 54 Stat. 986, as amended, 55 Stat. 23, 701, 56 Stat. 914, 57 Stat. 56, 601, 58 Stat. 55, provided for adjustments in the computation of base period income if the taxpayer established, among other things, "what would be a fair and just amount representing normal earnings" during the base period.

> reallocation of such income seemed to be materially less than for the other classes of income described above, the bill omits this item from the list of abnormal types of income for which a reallocation can be made." S. Rep. No. 2679, 81st Cong., 2d Sess. 14.

The House Committee Report was virtually identical. H. R. Rep. No. 3142, 81st Cong., 2d Sess. 13.

Taxpayers recognize, as they must, that Congress intended its change in language to limit the kinds of income eligible for relief. They say, however, that not all income from research and development was excluded. That which comes from inventions not merely patentable but also sufficiently revolutionary to be called "genuine discoveries" is still within the protection of § 456. We find it impossible to believe that an amendment designed to eliminate uncertainty and administrative discretion would introduce into the law—without a congressional word of warning or explanation—a distinction as vague, as dependent upon nuances of scientific opinion, and as unprecedented as that urged by taxpayers.

II.

Taxpayers have another argument, which the First Circuit rejected and which the Seventh Circuit did not reach. Paragraph (1) of § 456 (a) defines "abnormal income" as "income of any class described in paragraph (2)" which meets certain requirements. Paragraph (2) lists four classes of income and provides in its concluding sentence:

> "The classification of income of any class not described in subparagraphs (A) to (D), inclusive, shall be subject to regulations prescribed by the Secretary."

Taxpayers argue that even if the income here at issue was not provided for under any of the subparagraphs of paragraph (2), it is nevertheless included within this final sentence and is hence eligible for relief.

We need not decide the precise effect of the sentence relied on. In light of the clear purpose of Congress in enacting § 456 to cut down not only the amount of administrative discretion which had prevailed under the predecessor section but also the scope of available relief, the power of the Secretary to extend relief far beyond the four corners of the statute may be doubted.[14] It is sufficient to note that, unlike its predecessor (which made relief available for all "abnormal income," whether or not specified in a particular class),[15] § 456 applies only to those classes specified in § 456 (a)(2). Section 456 does not apply in terms to all abnormal income and contains no indication that the Secretary should create administrative classifications embracing all such income. And even if the sentence relied on gives the Secretary power to expand the classes of abnormal income somewhat beyond the four enumerated in the statute, he has clearly not done so here. The regulations[16] specifically provide that

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[14] In fact, the Committee reports state that "Adjustments . . . [under § 456] are limited to income arising out of" the four classes specified in subparagraphs (A) through (D). H. R. Rep. No. 3142, 81st Cong., 2d Sess. 13, S. Rep. No. 2679, 81st Cong., 2d Sess. 14.

[15] Excess Profits Tax Act of 1940, § 721, 54 Stat. 986, as amended, 55 Stat. 21. Section 721 (a)(1) defines "abnormal income" as "income of any class includible in the gross income of the taxpayer. . . ."

[16] Treas. Regs. § 40.456-2 (b) (1951), as amended, T. D. 6026, 1953-2 Cum. Bull. 235: "Other income, not within a class described in subparagraphs (A)-(D) of section 456 (a)(2), to which section 456 is applicable may be grouped by the taxpayer, subject to approval by the Commissioner on the examination of the taxpayer's return, in such classes similar to those specified in subparagraphs (A)-(D) of section 456 (a)(2) as are reasonable in a business of the type which the taxpayer conducts, and as are appropriate in the light of the taxpayer's business experience and accounting practice. Income from the sale of tangible property arising out of research and development which extended over a period of more than 12 months is not included in the list of abnormal types of income to which section 456 is applicable, and such income may not constitute a class

"Income from the sale of tangible property arising out of research and development which extended over a period of more than 12 months is not included in the list of abnormal types of income to which section 456 is applicable, and such income may not constitute a class of income for purposes of that section." This specific exclusion is clearly in furtherance of the purpose of Congress in deleting "research" and "development" income from its classification of abnormal income. The Commissioner, effecting the will of Congress, has barred relief for the type of income here at issue.

The last sentence of the regulation, on which taxpayers also rely, does not aid them. It provides merely that "research" and "development" income is eligible for relief if it is properly includible in a class of income to which § 456 otherwise applies. As we have held, however, taxpayers' income does not fall within any such class.

Therefore, the judgment of the Court of Appeals for the Seventh Circuit must be reversed and the judgment of the Court of Appeals for the First Circuit affirmed.

It is so ordered.

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of income for purposes of that section. However, section 456 is applicable to such income if the income is otherwise properly includible within a class of income to which such section is applicable for example, the class described in section 456 (a)(2)(D)."